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ABSTRACT

This booklet describes some of the practices of committees charged with setting the compensation of the college or university president or chancellor. Whether the institution is private or public, the president's income will become public information, and apart from any public relations implications, it simply makes good sense for the compensation of the chief executive to be set intelligently and responsibly with the full board's approval. The role of the compensation committee, or equivalent group, is to accomplish this objective in a way that provides for all reasonable protection of the chief executive's privacy while taking account of the significance of compensation as a means of recognizing achievement. Establishing a compensation committee is only one way of carrying out the compensation setting function, but it is important to keep the process of setting the chief executive's compensation separate from that of setting other administrative and faculty salaries. Designated committees must set goals, assess presidential performance, and survey the market. It should design the compensation package in consultation with the chief executive and the full board. The process must be established as policy by the full board and understood by the entire board as well. (SLD)

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EFFECTIVE COMMITTEES

THE COMPENSATION COMMITTEE

BY ROBERT E. TRANQUADA, M.D.

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The Compensation Committee

Observers of college and university governing boards agree that the foremost responsibility of these boards is to select and hire the chief executive. That accomplished, a commensurate high priority is to ensure that the compensation level and perquisites of the chief executive are appropriate to the position, adequate in the eyes of the incumbent, comparable to compensation at similar institutions, and set at a level with which the board itself is comfortable.

As it turns out, the methods boards use to achieve those outcomes vary considerably. Because there is no single correct structure or process, this booklet describes some best practices of committees charged with setting the compensation of the president or chancellor.

Committee Charge

In the past, the process of establishing the salary and benefits of campus chief executives was often relatively simple: The board chair and the president conferred privately and agreed on a figure, without consulting the board or its committees. In today's setting, a number of factors make such a process unwise, risky, and possibly illegal for the institution and even for individual board members.

Invariably, whether the institution is private or public, the president's income will become public information. The *Chronicle of Higher Education* publishes an annual review of chief executives' salaries and benefits based on information institutions provide to the Internal Revenue Service.

Since 1991, all tax-exempt private higher education institutions have been required to report the total compensation of their most highly paid individuals to the IRS on Form 990. This almost always includes the compensation of the president or the chancellor. The law prescribes that all institutions must make a copy of Form 990 available to individuals on request and, if the form is not readily available to the larger community, be responsive to requests.

Salaries for chief executives of public institutions are simply a matter of public record; nearly all public institutions are governed by sunshine laws that require public disclosure of the compensation of high university officials. In public institutions especially, governing boards will be judged by their probity in setting executive compensation and perquisites.

Private institutions now must deal with the additional issue of "intermediate sanctions." These are tax penalties the government can assess against presidents and even against individual board members if there is evidence of "excess benefits" in salary and benefits practices. These are brought into play when, in the judgment of the IRS, executive salaries and benefits exceed what the marketplace would support in each individual situation. Thus, it is incumbent upon each board to incorporate mechanisms for establishing executive compensation that both demonstrate a process that takes the marketplace into account and are understood and agreed to by the whole board.

Apart from these very serious considerations, it simply makes good sense for the compensation of the chief executive—at the original hiring and as subsequently revised—to be set intelligently and responsibly with the full board's approval. The role of the compensation committee is to accomplish this objective in a way that provides for all reasonable protection of the chief executive's privacy while taking account of the significance of compensation as a means of recognizing his or her record of achievement.

Committee Structure

Establishing a separate compensation committee is only one method of carrying out the compensation-setting function. In many institutions, the task is delegated to the executive committee, and in a few others to the human-resources committee or the finance committee (sometimes called

ESTABLISHING A SEPARATE COMPENSATION COMMITTEE IS ONLY ONE METHOD OF CARRYING OUT THE COMPENSATION-SETTING FUNCTION.

the budget committee). Those who favor charging the executive committee with the responsibility note that most executive committees are qualified to deal with this issue because the board chair presides and because membership includes, at a minimum, the board officers and the chairs of the standing committees.

The standing committee chairs should be in the best position of all board members to have good knowledge of the performance of the president or chancellor. These chairs will have had good opportunities to observe firsthand the effectiveness of executive leadership in each of the areas those committees oversee. Furthermore, compensation is uniformly a matter of great significance to the president (whether acknowledged or not), and there is an important message conveyed when the executive committee accepts this key responsibility.

An alternative view favors a compensation committee separate from the executive committee. Its proponents argue that the executive committee has enough to do without taking on presidential compensation. They say the compensation component requires focused attention on performance, which argues for a relatively small working committee. Finally, separating these duties from the powerful executive committee may be particularly advisable in the case of larger boards (of 35 members or more) for which the executive committee is authorized to make annual adjustments to the chief executive's compensation. In such cases, it is desirable to have a separate compensation committee that recommends actions to the executive committee. Put another way, if a board's executive committee also is envisioned as a compensation committee, it should be required to *recommend* action to the full board rather than to take the action itself.

Whatever approach is used, the responsibility for determining presidential compensation is most wisely placed in the hands of a well-qualified committee before the recommendation is brought to the full board. The issues involved are complex, and the need for openness between the committee and the chief executive suggests that this is not a function that a full board can carry out comfortably and efficiently. This arrangement also implies that the chair of the responsible committee will play a major role in setting the agenda for the process and will be the chief negotiator with the president or chancellor. Hence, this interactive function is best dealt with by the board chair, who usually chairs the executive committee at institutions that assign compensation to the executive committee. Institutions that create a separate compensation committee should include the board chair as either the chair or a member of that compensation committee. The point is, the compensation component of the board chair-president relationship should never be delegated.

It is important to recognize that the process of setting the chief executive's compensation must be distinct from that of setting other administrative and faculty salaries. Such salaries always should be set according to the recommendation of the president or chancellor, subject to policies established by the board, budgetary considerations, and review by the appropriate committee of the board. Setting compensation for faculty, senior staff, nonunion mid-level staff, and unionized hourly employees is a critical management tool that never should be subsumed by the board, though the compensation "pools" recommended by the president should be reviewed by the board as part of its oversight role.

Chief executive compensation, however, is an equally critical management tool that should be reserved to the board. Thus, when we speak of the compensation committee, we refer to its principal function: that of bringing a properly considered recommendation on *presidential* compensation to the full board.

Committee Responsibilities

Setting goals. Before the start of each academic year, perhaps in July or August, the board chair should invite the president or chancellor to provide a list of his or her goals for the coming year. (The list should include at least three goals, but not more than ten.) This process should result in a first draft of presidential goals for the institution. The chair

then can discuss with the president any additional recommendations for priorities or supplemental goals. After the president and board chair agree, these goals should be shared with the compensation committee and should be used as benchmarks for board evaluation of the president at the end of the year.

Certain objectives need not be repeated each year but should be clearly understood from the outset of the chief executive's term. These may include ongoing expectations for these and other objectives:

1. maintaining a balanced budget;
2. sustaining an appropriate level of student enrollment, retention, and quality;
3. ensuring institutional accreditation;
4. enhancing the general reputation of the institution;
5. careful management of student affairs;
6. maintenance of faculty quality;
7. attention to institutional morale;
8. dedication to maintaining the appearance of the campus;
9. compliance with audit and regulatory requirements; and
10. other standing objectives for the institution.

Certainly, every chief executive will be held accountable for these factors and others like them, regardless of whether they are specifically identified in the annual list of priorities. In addition, the central motivation for the president to pursue these goals should never be limited only to additional compensation.

Assessing presidential performance. Toward the end of the academic year, the chief executive should be asked to prepare a report that assesses progress on each of the annual and standing objectives. This report should address both the institution's progress and the president's progress in ways that inform the compensation discussion. It provides an opportunity to identify major external factors that may have intervened, to highlight achievements that may not have been on the annual list, and to set the stage for a discussion with the committee. It also may serve as a basis for the construction of the following year's objectives.

It is most helpful if the committee chair adds his or her assessments to the report as the basis for committee discussion (an additional reason for having the board chair also chair this committee). This provides closure on an important part of the process of setting compensation.

This assessment process should be made a regular annual event. It is not, however, a substitute for the periodic (perhaps every five years) formal presidential evaluation, which is described in detail in the AGB book *Presidential and Board Assessment in Higher Education*, by Richard T. Ingram and William A. Weary.

BECAUSE THE COMMITTEE IS DEALING WITH SENSITIVE INFORMATION, SOME OF WHICH MAY HAVE BEEN PROVIDED IN CONFIDENCE, COMMITTEE WORK SHOULD BE CONDUCTED IN PRIVACY.

Surveying the market. Except in unusual circumstances, it is advisable to provide the responsible committee with a market survey that indicates the compensation of leaders of comparable institutions and regionally competitive institutions. Most institutions identify data from a group of peer institutions of similar mission, size, and general reputation with which they compete for students, faculty, and leadership. In addition, useful comparative data are available from other types of institutions, such as museums, foundations, and professional societies, with which educational institutions frequently compete for leadership. Information gathered should include salary, benefits, special arrangements such as deferred income, and any other perquisites.

The most readily available national source of such information is the annual publication of presidential salaries and compensation in the *Chronicle of Higher Education*. Although the survey may provide useful information, its figures are derived almost entirely from the Form 990s filed by private institutions, and they always are reported a year later, meaning they are not current. Some observers have criticized Form 990 reports as being inconsistent because different institutions use different methods to report perquisites, benefits, and deferred compensation. For this reason, compensation committees should be reluctant to rely

exclusively on the *Chronicle's* report or other national or regional sources. It is probably better to seek additional strategies.

Another potential source is the Web site www.guidestar.org. The nonprofit Guidestar organization collects relevant information from more than 600,000 charitable organizations, including virtually all colleges and universities. Its figures also are derived from Form 990, and it is engaged in a national effort to provide greater consistency in data reporting from organization to organization. Guidestar's information also is likely to be from the previous year.

Customized market surveys are the best way to obtain the necessary comparative information. Such surveys, which identify peer and regional institutions, can be provided by a number of sources: compensation consultants, executive search firms, accounting firms, and others. Neither the president nor anyone on his or her executive team should be asked to perform this task because of the real risk of conflict of interest.

Because the committee is dealing with sensitive information, some of which may have been provided in confidence, committee work should be conducted in privacy. Conclusions must be shared with the entire board, but there is a lower chance for unintended release of sensitive information if the committee process is confidential. Most of the 22 states that require open meetings for higher education boards allow closed meetings for consideration of such personnel matters. The need for confidentiality also favors the use of a small committee rather than the board as a whole for arriving at a compensation recommendation for the chief executive, especially at private colleges and universities.

Asking questions within the committee. The process of reaching a consensus to bring a compensation recommendation to the board raises several questions the committee must be sure it can answer:

1. What does it take in terms of compensation, benefits, and perquisites to retain the services of an effective and well-respected president?
2. In light of total institutional budgetary considerations, what is a responsible level of presidential compensation?

3. Where do we want to stand among our peers in presidential compensation? What does it say to a chief executive when he or she is told that the answer is "at the median" or "at the top quartile"?
4. If we are considering an increase in compensation, should we consider providing some of it as a salary increase and some as a merit or incentive component that would not become part of the salary base?
5. Have we agreed at the beginning of this year on the major objectives we hope the institution will reach, and have we agreed on th priorities of those objectives?
6. Do we have adequate evidence of progress or lack of progress on each of the objectives?
7. Have we weighted the objectives with respect to how much they are actually responsive to presidential leadership or effort?
8. What overarching message do we want to deliver with the recommendation on compensation?
9. How likely are our colleagues on the board to agree with our conclusions?
10. How will we communicate our decision to the full board? Should it be communicated to anyone else? If so, how?
11. How will our decision be made public? How will the institution's constituencies—faculty, students, parents, alumni, major donors, peer institutions, legislators, the public, and the IRS—respond when they become aware of our decision?

The Committee's Agenda

Designing the compensation package. The construction of a competitive compensation package for the president or chancellor can be complex, and it is beyond the scope of this publication to provide more than a summary. Tax and other consequences make it essential that each institution consult legal counsel before completing such a package, and it is wisest if the legal counsel is obtained from a source outside the institution and board to avoid any conflict of interest.

Salary components may include a base salary to which may be added bonuses as incentives to meet certain objectives. The use of a bonus means that such recognition is not translated into the salary base but is considered an annual event. The use of deferred compensation is potentially complex, involves more than one option, and may involve state and federal tax consequences, especially for the incumbent chief executive.

Federal tax law requires that executive fringe benefits not meaningfully exceed those available to other employees. Thus, it generally is advisable to provide the president and other full-time employees with the same fringe benefits. Other perquisites, such as a car, presidential housing, travel allowances, child care, club memberships, entertainment allowances, and special sabbatical leave arrangements will vary by institution and must be tailored to fit the situation of the chief executive and the institution. These are best included in the initial employment agreement, though they may be reconsidered from time to time. Here again, it is wise to obtain legal counsel to avoid ambiguities or misunderstandings surrounding the terms' definitions as well as unintended tax consequences either for the president or the institution.

Compensation for the spouse is, again, a highly idiosyncratic matter. Policy will depend on the expected role of the presidential spouse, and this may range from having no recognized responsibility to the institution to having the responsibility of a full-time employee. Obviously, the wishes of both the chief executive and the spouse must be primary considerations. Tuition-remission arrangements for presidential offspring are highly individualized, but if they are part of basic faculty fringe benefits, they should be the same for the chief executive. Most important, compensation issues for spouses never should be relegated to marginal status.

Consulting with the chief executive. Nobody likes surprises—neither board members nor chief executives. Thus, after the compensation committee has agreed on a recommended compensation package, and before the recommendation goes to the full board, it is both wise and considerate for the board chair to review that recommendation with the president or chancellor. Nine times out of ten this will mean a simple exchange of information and agreement. Occasionally, though, the president may desire some fine-tuning of perquisites, announce a life or family change that deserves attention, or suggest other reasons for modifying the committee recommendation. Such a process allows the chief executive to

be prepared for the recommendation when it is taken to the full board and permits the board chair to inform the board that the matter has been reviewed by the chief executive and is acceptable.

Involving the full board. Because the full board will be held accountable for decisions involving executive compensation by all of its constituencies as well as the IRS, the full board must be significantly involved in the final decisions. This should begin with the establishment of written policies and procedures for everything discussed in this booklet, reviewed and approved by the full board.

The entire board should be informed of the compensation committee's reasoning and conclusions and should have an adequate opportunity to discuss and ratify the recommendation. Ordinarily, the compensation committee's report should be delivered to the full board in an executive session, and the board chair should convey the conclusion to the president or chancellor as soon as possible. In institutions where the president or chancellor is a member of the board, he or she usually will be excused from this discussion.

Finally, it is crucial for the committee chair to document the entire process in a "confidential memorandum for the record." This should include how the performance review was conducted (with the president's written self-review attached), how the comparative data were secured (also attached), and subsequent recommendations approved by the board. It should be made part of the chief financial officer's confidential files and made available for the institution's audit process.

Conclusion

Compensation of the president or chancellor has ramifications that extend beyond the relationship between the chief executive and the board. For this reason it is essential that the process of setting that compensation be established as policy by the full board and understood by the full board as well. The process itself can contribute to institutional goal setting, presidential assessment, and a full level of comfort on the part of the chief executive and the board. Properly managed by a compensation committee composed of senior board members, chaired by the board chair, and carefully reviewed by legal counsel, this process can provide all of these benefits. Finally, the board itself must be kept informed and, in most instances, will want to add its own stamp of approval.

Resources

Atwell, Robert H. and Jane V. Wellman. *Presidential Compensation in Higher Education: Policies and Best Practices*. Association of Governing Boards of Universities and Colleges: Washington, D.C., 2000.

Huang, Alice S. "Marriage Counseling for Boards," in *Trusteeship*, November/December 1999.

Ingram, Richard T. "Searching for Reason in Presidential Compensation," in *Trusteeship*, July/August 1997.

Ingram, Richard R. and William A Weary. *Presidential & Board Assessment in Higher Education: Purposes, Policies, and Strategies*. Association of Governing Boards of Universities and Colleges: Washington, D.C., 2000.

This publication is part of an AGB series devoted to strengthening the role of key standing committees of governing boards. Several assumptions underpin the series:

- The work of boards should be accomplished in committee. An effective committee system will enhance the productivity of full board meetings.
- The committee structure of any board should mirror the full range of its responsibilities as a legal, corporate entity. That is, the committee organization should cover the oversight roles expected of trustees.
- Although there is no optimum committee system, certain principles and procedures should prevail: The board's bylaws or other operating policy should include a clear, comprehensive statement of responsibility for each standing committee. Each committee should be staffed by an appropriate administrative officer; a trustee or regent should serve as chair. No trustee should serve on more than two active committees, preferably one—excluding the executive committee.
- Before scheduled meetings, each committee member should receive a concise, well-conceived meeting agenda and relevant background information prepared by the committee chair and staff. Committees are responsible for recommending decisions and actions to the full board.
- As committee members seek additional information to fulfill their responsibilities, it is important to strike a balance between "too much" and "too little." Committee members must guard against requesting overly detailed information to avoid the appearance of becoming embroiled in administration or overburdening it. Before members make information requests, perhaps they would be well-served by asking if all such requests contribute to the committee's and the board's responsibilities for reviewing, setting, or approving institutional policies.

The *Effective Committees* set of booklets comprises publications on the following committees: investment, buildings and grounds, academic affairs, student affairs, finance, development, trustees, audit, and executive. It is part of the AGB **Board Basics Series**. AGB and the authors welcome comments and suggestions to improve this publication and others in the series. Call AGB publications at 800/356-6317 or visit our Web site at www.agb.org for more information.

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